Meeting Date: May 28, 2014 **Called to Order**: 6:00 PM
Location: 1 Avenue A, Turners Falls MA

Finance Committee Members Present: John Hanold, Sharon Kennaugh, Lisa Adams, and Greg Garrison. Lynn Reynolds was absent. Michael Naughton arrived at 6:20 PM.

Selectmen Present: Mark Fairbrother and Christopher Boutwell. Michael Nelson was absent.

Others Present: Town Administrator Frank Abbondanzio, Town Accountant Carolyn Olsen, Airport Manager Michael Longo and Airport Commissioner Peter Golrick

Minutes
Selectmen Moved:
To approve the minutes of April 30, 2014.
Vote: 2 In Favor 0 Opposed _ Abstained

Finance Committee Moved:
To approve the minutes of April 30, 2014.
Vote: 4 In Favor 0 Opposed _ Abstained

Reserve Fund Transfer Request
The Airport Commission is requesting a Reserve Fund Transfer Request in the amount of $1,500 for the Airport budget. The budget had a variety of unusual and unexpected expenses.

Finance Committee Moved:
To transfer $1,500 from the Reserve Fund to the Airport budget.
Vote: 4 In Favor 0 Opposed 0 Abstained

The Town Administrator is requesting a Reserve Fund Transfer Request in the amount of $6,000 for the Colle Budget. The budget had unusual and unexpected expenses for a video intercom system and new carpeting required by the new lease agreement.

There will be a special article to reimburse the Town at the next special town meeting.

Selectmen Moved:
To recommend a reserve fund transfer of $6,000 to the Colle budget’s Building Repair and Maintenance line item. (228-5-183-5242).
Vote: 2 In Favor 0 Opposed 0 Abstained

Finance Committee Moved:
To transfer $6,000 from the Reserve Fund to the Colle budget’s Building Repair and Maintenance line item. (228-5-183-5242).
Vote: 4 In Favor 0 Opposed 0 Abstained

Financial Policies Manual and Objectives (see below for text)

- A main purpose of this proposed policy is to improve the Town's bond rating and reduce the interest costs for long-term debt.
- Mr. Abbondanzio presented a handout with answers to some of Mr. Hanold's questions.
- Mr. Naughton arrived at 6:20 PM.
- The policy, in many cases, formalizes current practice.
- There will be a meeting with Standard and Poor's in July. Having an approved policy may help the town be upgraded to an AA rating. The town is currently graded A+.
- There is a backlog of needed capital projects, especially facilities. It is important to get the best possible interest rate for that future borrowing.
- Draft policy also includes items that have been discussed and proposed, such as a separate stabilization fund for capital projects.
- Mr. Abbondanzio emphasized that these policies will not be cast in stone and that the document can be revisited and revised as necessary. In the meantime we can look at them as goals to strive for.
- There are 4 factors in bond ratings. The financial factor, including policies, is only one factor.
- The final policy needs to be acceptable to the Board of Selectmen, Finance Committee, and Capital Improvements Committee, although it only has to be approved by the Board of Selectmen.
- Mr. Abbondanzio then went through the entire policy.
- Mr. Abbondanzio is considering changing his recommendations to reduce the recommended levels of Free Cash and focus on having more money in Stabilization Funds.
- Mr. Abbondanzio is now recommending that reserves equal 10-15% of the prior year's general fund operating revenues.
- Mr. Naughton would like to see some actual numbers before the policy is adopted to have a better idea of what the percentages equal in dollar amounts. Ms. Olsen will provide this information before the next meeting.
- Having a framework for goals was welcomed.
- Mr. Abbondanzio went over his answers to Mr. Hanold's questions. (see below)

Selectmen adjourned at 7:55 PM

Topics not anticipated within in the 48 hour posting requirements-
GMRSD Superintendent Michael Sullivan has offered a presentation of the district's strategic plan. There may be a public forum at the high school on June 17th.

Set Next Meeting Date
June 11, 2014 Further discussion of Finance Policies
June 18, 2014 for potential reserve fund transfers
July 2, 2014 in case Ch 44 S33B transfers, reorganization, reconsideration of CPA

Meeting Adjourned at 8:10 PM

List of Documents and Exhibits

- Minutes April 30, 2014
- Reserve Fund Transfer Requests
- Draft Financial Management Policies and Objectives (below- starts on page 3)
- Mr. Hanold's questions (below – starts on page 20)
- Answers to Mr. Hanold's questions (below- starts on page 25)

TOWN OF MONTAGUE

FINANCIAL MANAGEMENT POLICIES AND OBJECTIVES

TOWN OF MONTAGUE
FINANCIAL MANAGEMENT POLICIES

I. OVERVIEW

It is the policy of the Town of Montague that financial management is conducted with the objectives of providing municipal service in an efficient, effective and consistent manner that aligns with the public policy goals as set forth by the Board of Selectmen.

Implementation of these policies shall be facilitated by the effective coordination of the "financial management team" including the Town Accountant, Town Treasurer/Collector, Director of Assessing and Town Administrator.

To help ensure the Town's financial stewardship, an established program of managing the Town's finances is essential. To this end, the Board of Selectmen promulgates policies and procedures that are financially prudent and in the Town's best economic interest.

In adherence to this policy, the Town shall pursue the following objectives:

- To set forth operational principles that minimize the cost of government to the extent consistent with services desired by the public and that minimizes financial risk;
- To continue effective financial management within the Town that conforms to generally accepted accounting principles;
- To simplify, clarify and modernize the financial systems of the Town as the need occurs;
- To provide increased public confidence in public financial management;
- To protect and enhance the Town's credit rating and prevent default on any municipal debts; and
- To provide safeguards to ensure the quality and integrity of the financial systems.

Why the Town should adopt financial policies and procedures:

- **It provides a historical basis for future direction;**
- **It provides consistent guidelines for financial activities; and**
- **It sets a foundation for financial decision making.**

In order to attain the above objectives, the Board of Selectmen adopts the following policies:

II. ACCOUNTING, AUDITING AND FINANCIAL PLANNING

A. The Town will utilize accounting practices that conform to generally accepted accounting principles (GAAP) as set forth by the Government Accounting Standards Board (GASB). The Town will comply with GASB Statement 34 and continue to track, to report and to depreciate capital assets as required. The Town will comply with GASB Statement 45 regarding accounting for Other Post-Employment Benefits (primarily health insurance) to retired employees. ACCOUNTING REQUIREMENT

B. An annual audit will be performed by an independent auditing firm. The audit serves as a valuable management tool for evaluating the fiscal performance of a community.

C. The annual audit shall be provided by the independent public accounting firm no later than March 1 and reviewed by an Audit Committee. The Audit Committee shall be comprised of the Town Administrator, Town Accountant, Treasurer-Collector, and representatives of the Board of Selectmen, Finance Committee, and Capital Improvements Committee.

Why this policy requiring conformance with generally accepted accounting practices (GAAP) is important:

- **Assures "legally defensible" accounting**
- **Conforms to bonding requirements**
- **Conforms to town budgeting policy**
- **Provides consistency of budgeting and accounting over time; and**
- **Ensures "clean audits"**

D. A five-year financial projection shall be prepared annually by the Town Administrator and Town Accountant, projecting revenues and expenditures for all operating funds. This projection shall be used as a planning tool in developing the following year's operating budget and capital improvements plan. Revenue forecasts for property tax, local receipts and state aid shall be conservative, using generally accepted forecasting techniques and appropriate data. Revenue deficits will be avoided at all costs. To avoid any potential for such a deficit, estimates for local receipts (i.e. excise taxes, trash sticker fees, inspection fees, investment income, departmental user fees) will generally not exceed 100% of the prior year's actual collection without firm evidence that revenues will be achievable.

Why multi-year financial planning is important:

- **Like any business, a town should strive for financial stability year after year**
- **Prudent financial goals can minimize costs over the long term**
- **Provides citizens and business with confidence, knowing that strong, consistent financial policies are in place guiding their community**

III. GENERAL

A. Budget Goals and Objectives shall be determined annually by the Board of Selectmen in consultation with the Town Administrator. However, the annual operating budget as submitted to the Town must be balanced with the estimate of proposed expenditures for a fiscal year less than or equal to the proposed revenues. In short, all current operating expenditures should be paid for with current operating revenues.

Why this policy is important:

- **The purpose of this policy is to maintain a fiscally sound operating position for the Town by promoting Montague's ability to balance its budget on a current basis, maintain reserves for emergencies and have sufficient liquidity to pay bills on time to avoid short term borrowing costs. The Town will avoid budgetary procedures that balance current expenditures at the expense of meeting future years' expenses, such as delaying expenditures until the next fiscal year or rolling over short-term bond or grant anticipation notes.**

B. Per MGL, long-term debt will not be used to fund current operating expenditures.

C. The Town will carefully and routinely monitor all amounts due the Town. An aggressive policy of collection will be followed for all receivables, including property taxes. An average collection rate of at least 95% of current levy shall be maintained.

D. Charges for services and other revenues shall be reviewed on a regular on-going basis at least every three years. Charges shall be adjusted as necessary to respond to changes in the cost of providing services. The Board of Selectmen may set specific cost recovery goals for individual departments or services as appropriate.

1. Recreation Department-Recreational user charges and fees will be set to recover approximately ___% of the total direct costs associated with recreational programs.

E. One-time revenues will be used for capital improvements, additions to reserves or as legally restricted to a specific purpose by the funding source.

F. The year-to-year increase of actual revenue from the property tax levy shall generally not exceed 2.5% pursuant to the limitations of Proposition 2 ½. STATE LAW.

G. Property values shall be based on an analysis of market conditions along with the assessment level and uniformity must be performed annually as of January 1 whether for the triennial certification or for an interim year adjustment. STATE LAW.

H. The Town will strive to be informed and aware of all grants and other aid that may be available to us. All potential grants and other aid shall be carefully examined for matching requirements (both dollar and level-of-effort) and restrictive covenants, to ensure that our participation in such grants will be beneficial and cost effective. When positions are funded with grants, a portion of the grant funding will be allocated to recover the cost of employee benefits if allowed by the granting agency.

I. Each year and whenever appropriate, existing revenues will be reexamined and possible new sources of revenues will be explored to ensure that the Town is maximizing its revenue potential.

IV. RESERVES

A. The Town's total Reserves, including the Town's combined Stabilization Funds and Free Cash, should be maintained at 10% - 15% of the Town's prior year's General Fund Operating Revenues. The primary objective of the Town's reserve policy is to provide the Town the flexibility to sustain service levels despite the adverse financial impacts of economic downturns and unforeseen and extraordinary expenses.

Why this policy is important:

- **This goal is a widely accepted measure of good financial standing and a key factor in the bond rating of a town. It is also recommended by the Government Finance Officers Association (GFOA). The Free Cash balance is an important indicator of whether the Town is living within its means. A declining balance means that the Town is spending more on an annual basis than it is collecting in revenues.**

- **Free Cash provides a financial cushion against events such as a sudden loss of a revenue source after Annual Town Meeting has approved the operating budget for the next fiscal year, an economic downturn, emergency or other unanticipated expenditures, non-recurring capital expenditures, and uneven cash flow.**

B. The General Stabilization Fund is the Town's main reserve fund designed to provide financial stability for the Town while improving the Town's credit worthiness and flexibility. The provisions of this fund are dictated by Massachusetts General Law, Chapter 40, Section 5B.

C. The Town will endeavor to maintain a General Stabilization Fund large enough to buffer the general fund from the impact of two to three years of reduced state aid and/or declining local receipts. At a minimum the balance in the General Stabilization Fund shall be maintained at 5% of the Town's General Fund (operating budget) Expenditures.

Why this policy is important:

- **During the most recent downturn in the economy (the "Great Recession") FY 2009 - FY 2013, the Town of Montague lost approximately thirty percent (close to $500,000) of its state aid. The Town has recovered only a fraction of the revenue loss.**

D. In order to meet this target the Board of Selectmen may recommend at a Town Meeting to transfer an amount of at least 5% of the prior year's tax levy net of excluded debt from certified Free Cash into the General Stabilization Fund. At no time may an appropriation into this fund exceed 10% of the previous year's tax levy, nor can the fund exceed 10% of EQV.

- **The Board of Selectmen and Finance Committee has informally implemented a policy of augmenting the General Stabilization Fund through transfer from Free Cash. This policy needs to be formalized and continued.**

E. The General Stabilization Fund may only be used under the following circumstances:

2. To fund capital projects on a "Pay-as-you-go" basis, when the Capital Improvements Stabilization Fund has reached its "floor"
3. To support the operating budget when the General Fund Operating Revenues increases less than 2.5% from the prior fiscal year.

F. The Town will make withdrawals from the General Stabilization Fund that will reduce the balance of the fund below the 5% minimum only in response to extraordinary and unforeseen financial obligations that pose an immediate threat to the Town's financial stability and which cannot be funded using other available sources.

G. If the Town withdraws money from the General Stabilization Fund that would reduce the balance of the fund below the 5% minimum, the Town must also present a plan for replenishing the fund. Replenishment funding shall come from Free Cash or from revenue. If Free Cash or revenue is insufficient to replenish the General Stabilization Fund in the immediately following fiscal year, the replenishment shall occur as soon as Free Cash or revenue is available.

Why this policy is important:

- **Withdrawals from the General Stabilization Fund (below an established floor of 5% of the Town's General Fund Operating Budget) are only meant to be temporary in nature to deal with unanticipated or unforeseen extraordinary needs of an emergency nature; for example, costs related to a natural disaster or calamity, an unexpected liability created by Federal or State legislation, immediate public safety or health needs, revenue shortfalls, opportunities to achieve long term savings, or planned capital investments and related debt service.**

- **The amount the Town has in its Reserves balance plays a major role in the Town's bond rating. A sudden decline in Reserves may be temporary or a planned event but a constant decline or reduction below the 5% floor may indicate a problem in meeting current expenditures and revenue targets, subsidizing the current operating budget, planned capital investments, or utilizing reserves for purposes not planned.**

H. Free Cash is the remaining, unrestricted reserve fund resulting from operations of the previous fiscal year. The composition of Free Cash includes unexpended Free Cash from the previous year, actual receipts in excess of revenue estimates and unspent amounts in the budget line-items. Once certified, monies held in this reserve may be appropriated during the current budget year and may also be used as a source of revenues for the ensuing budget year. The Town will endeavor to generate annually a certified free cash balance of at least 5% of the Town's General Fund Operating Revenues. This reserve shall be available in case of emergencies.

I. Free Cash in excess of the 5% goal should be used for non-recurring or emergency expenditures or appropriated to the General Stabilization Fund for future capital projects and equipment purchases. This would include funding of capital projects with an estimated cost of between $100,000 and $500,000 for which long term borrowing is authorized at terms of five or fewer years. Free Cash may also be used to subsidize the ensuing year's annual operating budget. However, it is the Town's goal to ultimately pursue a transition from using Free Cash to fund recurring operational expenses to using Free Cash to fund non-recurring expenses, such a capital expenses.

J. The Town shall also maintain a Capital Improvements Stabilization Fund (CISF) with annual appropriations of up to 2 % of Town's prior year's General Fund Operating Expenditures, said amounts to be appropriated from excess Free Cash. A minimum balance of $25,000 shall be retained in this fund.

Why adopt a policy establishing a Capital Improvements Stabilization Reserve Fund:

- **At a time when cities and towns are faulted for operating in a perpetual crisis mode, for allowing municipal assets to deteriorate, and for general short-sightedness, a special purpose stabilization fund can be an effective planning tool.**

- **A Capital Improvements Stabilization Fund enables the Town to keep on top of its asset replacement needs. It could, for example, be targeted to pay solely for the maintenance and repair of municipal buildings or vehicle replacement program, including setting aside a certain amount each year in anticipation of a planned, large equipment purchase.**

- **As a Massachusetts Department of Revenue circular points out, such a policy encourages a community to think long-term, to save money, to manage debt and to build resident confidence in government.**

K. The overall level of financial reserves is critical to maintaining the Town's bond rating and ensuring sufficient funds to manage unanticipated needs. Funds shall be allocated from reserves only after an analysis has been prepared by the Town Administrator and/or Town Accountant and presented to the Board of Selectmen and Finance Committee. The analysis shall provide sufficient evidence to establish that the remaining balance is adequate to offset potential downturns in revenue sources and provide sufficient cash balance for daily financial needs.

V. CAPITAL PLANNING

A. In 1978, the Town of Montague established a Capital Improvements Committee for the purpose of long term capital planning. Section 6 of Article II of the By-Laws of the Town of Montague states: "Capital Improvements Committee: There shall be a Capital Improvements Committee consisting of one member appointed by and from the Planning Board, and five additional members to be appointed by the Moderator, with powers and duties to include: (a) to conduct an annual review of the capital improvements program of the Town as well as proposals for the construction of municipal buildings and acquisition of property, (b) to make recommendations to the Town Meeting regarding the above, and (c) to prepare an annual report.

B. The Town shall continue to prepare a six-year Capital Improvement Program (CIP) updated on an annual basis.

C. On or before January 15 of each year, the Town Administrator, after consulting with town departments and the regional school districts, will submit capital requests to the Capital Improvements Committee. The proposed program will detail each capital project, including the description, estimated costs, and funding sources.

D. The Capital Improvements Committee, after reviewing and evaluating individual project requests, prioritizing these requests, and considering existing financial constraints, will prepare a six-year Capital Improvement Plan that includes the ensuing fiscal year (capital budget) as well as a five year projection of capital needs and expenditures (capital program), with estimated cost, description and anticipated funding sources for capital projects for the subsequent five years of the plan.

E. Capital policies adopted by the Town are listed below.

4. A Capital Project is a tangible asset or project with an estimated useful life of five (5) years or more, and a cost of $25,000 or more. Among the items properly classified as capital improvements are:
    a. New public buildings, or additions to existing buildings, including land acquisition costs and equipment needed to furnish the new building or addition for the first time;
    b. Major alterations, renovations, or improvements to existing buildings that have a useful life of at least ten (10) years;
    c. Land acquisition and/or improvements, unrelated to public buildings, but necessary for conservation, recreation or off-street parking;
    d. Major equipment acquisition, replacement or refurbishment, including but not limited to vehicles, furnishings, and information technology systems' hardware and software or other items that combined in purpose together make it a Capital Project;
    e. New construction or major improvements to Town's physical infrastructure, including streets, sidewalks, stormwater drains, and the sanitary sewer system. Infrastructure improvements must extend the useful life of the infrastructure by at least ten (10) years to be appropriately classified as a Capital Project;

f. Feasibility studies, engineering design services, or consultant services which are ancillary to a future Capital Project.

5. Guidelines for prioritizing capital projects (not necessarily in priority order):
   a. Imminent threat to health and safety of citizens, employees or property (e.g. police cruisers and radios, repairs to unsafe buildings);
   b. Maintenance and improvement of capital assets (e.g. major repairs of buildings, replacement of vehicles and equipment, park and play area renovations)
   c. Requirements of state or federal law (e.g. asbestos cleanup program, removal of gas tanks, new NPDES treatment requirements);
   d. Improvements of the infrastructure (e.g. streets and sidewalks, sewer programs);
   e. Improvements/maintenance of productivity (e.g. equipment replacement, computer hardware/software);
   f. Improvements of an overburdened situation (e.g. Town Hall renovations)
   g. Newly identified need (e.g. recreation field);
   h. Priority assigned by Department (Very High, High, Medium, Low); and
   i. Consistency with and in furtherance of long-term planning objectives of the Town (e.g. Energy Efficiency, Historic Preservation)

F. The capital program will be funded by a combination of Town General Operating Revenues, enterprise fund revenues, special purpose funds of the Town, and grant funds from the federal and state governments.

G. Montague recognizes that much of the Town's wealth is invested in capital plant (i.e. land, buildings, infrastructure, equipment and vehicles). Furthermore, that long term debt is an appropriate source of funding for certain types of projects while current revenues should be used for those assets with a short useful life.

H. The annual budget should have a Capital Program that includes debt service obligations and cash-funded (pay-as-you-go) capital projects funded from current revenues equal to at least 10% of the estimated property tax levy. This does not include capital projects funded via debt exclusions (debt excluded from Proposition 2 ½ limits). If in any year funds for the capital program recommended to Town Meeting are below the target allocation of 10% of estimated property tax levy, a plan will also be presented to replenish funding of the capital program to 10% within a reasonable time frame

I. Annual budgets shall strive to allocate 20% of the prior year's tax levy from new growth/construction to a Capital Projects Stabilization Fund.

Why these policies are important:

These policies recognize that much of the Town government's wealth is invested in our capital plant (i.e. land, buildings, infrastructure, equipment and vehicles. Long term debt is an appropriate source of funding for certain types of projects while current revenues should be used for those assets with a short useful life. This goal will provide a source of funding that does not compete with the operating budget, but increases or decreases in relation to growth in the tax levy and growth in the community.

J. Pending a rigorous analysis, the Town will as a rule target 2% of annual General Fund Revenues as a goal for funding building renewal projects and equipment replacement.

Why this policy is important:

This policy establishes a specific target for the annual funding of building renewal projects and equipment replacement. It affirms the importance of keeping on top of building repair and maintenance and scheduled equipment replacement. This also enables the Town to avoid the cost of deferred maintenance in future budgets.

K. The Town will emphasize preventive maintenance as a cost-effective approach to infrastructure maintenance. Exhausted capital goods will be replaced as necessary.

L. The annual operating cost of a proposed capital project, as well as debt service costs, will be identified before any long-term bonded capital project is recommended.

VI. DEBT MANAGEMENT

A. The town's bond rating is important because it determines the rate of interest it pays when selling bonds and notes as well as the level of market participation (number of bidders). Other things being equal, the higher the bond rating, the lower the interest rate. Bond analysts (Moody's, Standard and Poor's, Fitch) typically look for four sets of factors in assigning a credit rating.

1. Debt Factors: debt per capita, debt as a percentage of equalized valuation, rate of debt amortization and the amount of exempt versus non-exempt debt.

2. Financial Factors: Operating surpluses or deficits, free cash as a percentage of revenue, state aid reliance, property tax collection rates, unfunded pension liability.

3. Economic Factors: property values, personal income levels, tax base growth, tax and economic base diversity, unemployment rates and population growth.

4. Management Factors: governmental structure, the existence of a capital improvement plan, the quality of accounting and financial reporting, etc.

B. The Town will continually strive to improve its bond rating through the implementation of sound financial management, improved receivables management, accounting and financial reporting, increased reserves such as the General Stabilization Fund and the adoption of the following debt management policies and procedures.

C Long term debt will be issued only for objects or purposes authorized by State Law (Chapter 44, Sections 7 and 8) and for capital projects or assets that have a long useful life. Long term debt should be used to pay for the cost of significant infrastructure or capital projects, such as land and equipment purchases, building construction or remodeling, sewer and road construction.

Why this policy is important:

- **Debt is an effective way to finance capital improvements or to even out short-term revenue flows. For certain capital projects with a long useful life, debt financing is an equitable financing strategy that allows current and future beneficiaries of a capital investment to share in the cost of that improvement. Unlike most personal or private debt, towns have access to capital at very competitive tax exempt rates.**

- **Properly managed debt helps to preserve the Town's credit rating, provides flexibility in current and future operating budgets, and provides the Town with long-term assets that maintain or improve our quality of life.**

D. The Town will not use the proceeds of long-term debt to fund current, ongoing operations. Capital items costing less than $25,000 shall be financed through the operating budget.

E. The Town will confine long term borrowing to capital improvements and projects that cost at least $25,000, cannot be financed from current revenues and have a useful life of at least five years, or will prolong the useful life of a capital asset by at least five years.

F. The Town shall continue the policy of seeking voter-approved debt exclusion overrides to finance major new construction projects or significant renovations and capital expenditures in excess of $500,000.

G. The Town will, to the extent possible, use available funds such as Free Cash, prior year special article surpluses, grants, etc. to reduce the amount of borrowing required for a Capital Project.

H Where possible, the Town will use special assessments, revenues or other self supporting bonds, instead of general obligation bonds. Sewer main replacements, treatment facilities, pump stations, transportation and other infrastructure should be scheduled so as to avoid major increases in sewer rates and other user fees.

Why this policy is important:

- **Enterprise funds are established as self-supporting on a cash basis. Each enterprise fund should be reviewed annually to project revenues and expenditures for the next fiscal year. Estimates of capital projects and debt service should be included in order to project the impact on rates and user fees. Any costs not supported by revenues or betterments would place a requirement on the General Fund for financial support.**

- **Depreciation of sewer assets is not funded; therefore, a carefully designed replacement plan is necessary to ensure a rate structure adequate to pay all costs including proposed new long-term debt. It is suggested that a Sewer Capital Improvements Stabilization Fund be established and funded with an annual appropriation in the WPCF budget with a goal of appropriating an amount equivalent that year's depreciation.**

I. Borrowing purposes and maximum loan durations are set out in Chapter 44, Sections 7 and 8. The Town will strive to issue debt for shorter periods than the maximum allowable when the statutory limit exceeds 10 years; and except for major buildings, sewer projects and land acquisition, the Town will limit bond maturities to no more than 10 years. Under no circumstances should the Town schedule debt for repayment for a term greater than 30 years.

Why this policy is important:

- **Debt service costs include annual principal and interest payments. Debt service costs are also a significant portion of fixed costs. A reasonable maturity schedule not only reduces interest costs, but recognizes that capital needs will continue to be identified and recommended. Credit rating bureaus review these maturity schedules and future capital needs.**

J. Long term debt shall not be incurred without a clear identification of its financing sources including a consideration of its impact upon the operating budget.

Why this policy is important:

- **Capital projects may increase future expenses, decrease future expenses, or may be cost neutral. The funding of capital projects may fall within available revenues (taxes or user fees) or new revenue sources (debt or capital exclusions). It is important to project the impact that the proposed**

capital project has on the operating budget so that the operating budget funding sources could also be identified or new funding sources recommended.

K. The Town will endeavor to manage debt so as not to exceed the following ratios, which are reflective of municipal bonding standards:
   1. Gross General Fund debt service/General Fund Expenditures 15% "ceiling"
   2. Net General Fund debt service/General Fund Expenditures 8–10% "ceiling"
   3. Net General Fund debt service less debt exclusions 5% "ceiling"

L. Definitions of Gross/Net Debt Service:
   1. General Fund Gross Debt Service: Annual debt payments (principal and interest) for which the Town if held accountable; inclusive of assessments from Regional School Districts, Town appropriations and debt exclusions. Excluded are Sewer Enterprise Funds.

   2. General Fund Net Debt Service: After State reimbursements and State School Building Assistance Aid, the annual debt payments (principal and interest) for which the Town is held accountable; inclusive of assessments from Regional School Districts, Town appropriations, and debt exclusions (i.e. Gross Debt Service less reimbursements). Excluded are Sewer Enterprise Funds.

   3. General Fund Net Debt Service (less debt exclusions). Same as General Fund Net Debt Service but does not include excluded debt and sewer enterprise debt.

M. Debt service on an annual basis, not including projects funded by debt exclusion, shall not be less than 2% of the annual operating budget (debt service "floor").

Why this policy is important:

- **A "debt floor" should be established to ensure that the Town is making a minimum investment in protecting its capital assets; and that the Town is not just "kicking the can down the road" and deferring badly needed improvements.**

N. When considering the use of debt, the Town shall be guided by the following:

   1. Borrowing versus Cash - The Town will endeavor to finance Capital Improvement Projects with a total cost of less than $50,000 through cash appropriation rather than borrowing.

   2. Useful Life - When borrowing, the Town will ensure that the term of the bonds issued will not exceed the life of the project.

3. Capital Expenditure versus Capital Improvement Project - Capital expenditures not meeting the definition of “Capital Improvement Projects” should be financed through inclusion within operating budgets.

O. The Town will attempt to maintain a long-term debt schedule so that at least 50% of the outstanding principal will be retired at the end of 10 years.

P. Short-term debt, such as bond anticipation notes, tax anticipation notes, or grant anticipation notes, may be used when it provides immediate financing and an interest rate advantage, or if there is an advantage to aggregating multiple authorizations or to delaying long-term debt until market conditions are more favorable.

Q. The town shall borrow for a term of up to 15 years in anticipation of reimbursements from betterments, as authorized by Chapter 371 of the Acts of 2010, in cases where a limited segment of the community is receiving the benefit from a public improvement. This funding source will contribute all or a portion of the costs associated with a capital project.

VII. DEFINITIONS

A. Town’s General Fund Operating Revenues: The total of the Town’s net tax levy less excluded debt, net state aid, and local estimated receipts

B. Town’s General Fund Operating Expenditures: The total of the Town’s general fund operating budget, school district assessments, taxation share of enterprise fund budgets, and special article appropriations that are not capital projects.

C. Bond Anticipation Notes (BAN): Short term debt instrument used to generate cash for initial project costs and with the expectation that the debt will be replaced later by permanent bonding. Typically issues for a term of less than one year, BANs may be re-issued for up to five years, provided that principal repayment begins after two years (MGL Ch. 44 section 17).

D. Free Cash: Now referred to as “undesignated fund balance”. A revenue source that results from the calculation, as of July 1, of a community’s remaining, unrestricted funds from operations of the previous year, based on the balance sheet as of June 30. It typically includes actual receipts in excess of revenue estimates and unspent amounts in departmental budget line-items for the year just ending, plus unexpended free cash from the previous year. After the books are close for the year, potential available funds’ balances are submitted to the State for certification. Certification of Free Cash is generally submitted to the Department of Revenue in the summer with final certification in late summer or early fall. The Town’s goal is to have a certified Free Cash balance, certified as of July 1, at least 5% of General Fund Operating Revenue.

E. GASB34: A major pronouncement of the Governmental Accounting Standards Board that establishes new criteria on the form and content of governmental financial statements. GASB 34 requires a report on overall financial health, not just individual funds. It requires more complete information on the cost of delivering services and value estimates on public infrastructure assets such as bridges, roads, sewers, etc. It also requires the presentation of a narrative statement analyzing the government's financial performance, trends and prospects for the future.

F. GASB 45: This is another Governmental Accounting Standards Board major pronouncement that each public entity account for and report other post-employment benefits (OPEB) in it accounting statements. Through actuarial analysis, municipalities must identify the true costs of the OPEB earned by employees over their estimated years of actual service.

G. Debt Service: Payment of interest and principal related to long term debt.

H. General Stabilization Fund: A general reserve. Money from this fund may be appropriated by two-thirds of Town Meeting. The Town has established a goal of maintaining a minimum balance of at least 5% of General Operating Revenue in its General Stabilization Fund.

I. Capital Stabilization Fund: A special stabilization fund established specifically for the purpose of funding capital projects including vehicle/equipment replacement and building repairs/maintenance on a "pay-as-you-go" basis. The town's goal is to maintain a minimum balance in this fund of at least 2% of General Operating Revenue.

John Hanold's COMMENTARY ON DRAFT FINANCE POLICIES FOR MONTAGUE

Abbondanzio Draft 19 May 2014

Re: Covering email 19 May 2014

- There is a reference to a "scheduled conference with Standard & Poor;" when is that set?
- There are references to "upcoming bond offering," and later to "over the next 3 to 7 years." Are these two different projected offerings or the same? See also comments below on Scope of Policies.
- Concerning the research on two dozen communities: who were the towns surveyed? Was the internet research followed by contact with the towns themselves? Was there feedback on the extent of the towns' compliance with the stated policies, staff or citizens' satisfaction with them, evaluation of them by bond-rating, Dept of Revenue or other outside bodies?

Scope of Policies

From the **Definitions** section it appears the draft's scope excludes the Airport, Treatment Plant, and Colle Bldg. , since user fees and Colle "Rev. Reserved for Approp." are not included in Revenue, and Retained Earnings and Colle Operating Fund are not included in Reserves. However, later sections seem to have a broader scope, and the definitions appear to include part of the Expenditures for those units.

Evaluation of Montague's financial health will undoubtedly consider the operation and sustainability of the Treatment Plant and Airport. The stated boundary seems awkward, and can mean different things in different years (e.g., in some years the Airport meets some of its spending from Ret. Earn., some from Taxation, some from User fees, etc.)

Sec. VII Definitions

- It seems inconsistent to define the Net Tax Levy without excluded debt, but then not to exclude the corresponding part of Debt Service. Furthermore, the Operating Revenue definition does not recognize the use of reserves (Free Cash) for operations.
- Since the Net Tax Levy includes a provision for Abatements & Exemptions, perhaps the Assessors' Overlay should be defined as a Reserve and a potential revenue source.
- If we are documenting policies as a combination of how they exist now and how we propose to expand them, we should flag Capital Stabilization as "yet-to-be-created" and specifically include the GMRSD and FCTS Stabilization funds, which already exist.
- The appropriation threshold is listed for General Stabil. but not Capital Stabil. I assume it's a 2/3 T.M. vote for both? Neither definition indicates how funds are deposited into them (unlike the Free Cash definition). Conversely, there is no indication of how or when Free Cash is appropriated to uses.
- The GASB 34 definition refers to "value estimates" for infrastructure assets, which begs a definition of "value estimates."

- The re-naming of Free Cash as "undesignated fund balance" was unexpected, but all references in the other sections continue to cite Free Cash. Given common usage, in town and all over the state, isn't continuation of the term "Free Cash" clearer?
- I suggest the goals for the size of Free Cash and Stabilization be separated from their definitions (cover the goals in Sec. IV). Is there a rationale for the calculations being based on G.F. Operating Fund Revenue for Free Cash, but Operating Fund Expenditures for the reserves?
- There is no definition for Capital Projects. This area may be difficult to clearly communicate, since the character of a project and its funding source may not always be parallel. Conceivably a defined-capital item can be funded from taxation (cruiser) and a non-capital item from reserves (DPW Repairs, at the moment). This gets murky in Sec. V.
- There is no reference to sources and uses related to Program Income. Among the many miscellaneous funds and accounts, not otherwise worth covering, is it worth at least acknowledging the existence of this fund, and the ways it is replenished and used?

Sec. I Overview

- Has the Board of Selectmen indeed set forth public policy goals with which these policies should be aligned? (would be logical for S&P or voters to ask for this).
- Sentence before bullet list might better read: "Adherence to these policies will assist the Town to achieve the following objectives:"

Sec. II Accounting Auditing and Financial Planning

- Here's a suggestion from some legal people I've dealt with over the years: throughout a document like this, use "WILL" for predictive situations (intentions over time, e.g. "The BOS will consider this at a future meeting.") and use "SHALL" for prescriptive situations (e.g. "The BOS shall comply with the Open Meeting Law.")
- Here (in para. C and D) and later, there are references to bodies and documents (e.g., Audit Committee, five-year financial projection) that are not presently "active." There is no indication of timing or results of an Audit Committee's review. In para. D there is a detour into some mechanics that seem closer to the material in Sec. III.

Sec. III General

- This section heading could be more specific; with the exception of para. A it seems to focus on Revenue forecasting. Is it contemplated that an equivalent section on Expenditure forecasting will be added later? Although you've emphasized bond ratings as a principal driver for policies, a broader coverage isn't out of the question.
- Para. F and G flag STATE LAW. Do you intend to add a M.G.L. citation? It may be that the mandated provisions here (para. B, F and G) can be covered in one paragraph, to distinguish them from our own discretionary guidelines.
- Para. D is a great inclusion, but I wonder why the cost-recovery goals stop with Parks & Rec, and how their goal will be set. It seems that trash stickers, airport user fees (if Airport is within scope) and other services might also be covered here.

Sec. IV Reserves

- This is a very ambitious section, with a number of prescriptive statements and calculations. In addition to the "will" vs. "shall" review mentioned earlier, it might be worthwhile putting the general guidelines (para. A and K) first, then covering all Free Cash items (including usage) next, then transfers to Stabilization and their uses, etc. I note that the formal analysis required in para. K seems much more extensive than our current practice. Is this tightening-up necessary?
- What is the rationale for setting separate goals for the size of Free Cash (para. H and in Definitions) and Stabilization (in Definitions, but not in this Section) when an overall goal is set in para. A ? It seems unnecessary to erect a boundary between the parts unless separate management is really desirable.
- Unless we feel it desirable to set different definitions of when reserves can be used, I suggest we use the same words each time. It's "unforeseen and extraordinary expenses" in para. A, multiple tests in para. F, "in case of emergencies" in para. H, etc. There may be no need to bound this too tightly.
- Concerning Free Cash: suggest you leave its definition in Sec. VII and don't repeat it in Sec. V. H. The comment in para. H on how and where it's appropriated (should add "by whom, what approval level") is useful, but offering it for appropriation during the year or the following year seems to conflict with statements elsewhere about "living within current revenue" (incl. Definition para. A, and General para. A)
- We may chose to set a separate goal for Free Cash levels, but it deserves its own paragraph – in which I would not recommend having an objective to generate Free Cash equal to any particular percentage of anything. I'd support an objective to budget revenues cautiously, per Sec. II. D., and budget spending realistically. The Free Cash balance simply happens, and is not "managed" by itself.
- Similar to above: I don't see the need to specify in detail when we do or don't move Free Cash to Stabilization, and how much. The processes described in para. D, G and I are more lengthy, complex and restrictive than necessary. In para. D, for example, this policy would base the recommended transfer from Free Cash to Stabilization on projected prior-year revenue, not the certified Free Cash balance. Since the revenue yardstick for FY2015 is around $13,800 K we now should ALREADY be recommending a transfer of about $690 K at our next Special Town Meeting, though the Free Cash balance is as-yet-uncertified.
- The para. I text on what is a large enough capital item (looks more restrictive than in Capital Section VI) can be omitted, and the focus can be on preferring the higher visibility and stiffer approval level for any appropriation from Stabilization (2/3 not majority).
- Concerning Stabilization: what is the rationale for separating General and Capital Stabilization, other than the fact that other towns may do it? As Carolyn has pointed out several times over the years, Town Meeting can re-define the scope and use of these funds at any time (and the M.G.L. constraints are already cited in para. B), and the distinction between Capital (however defined) and General may be unduly arbitrary and murky. Furthermore, the language in para. E indicates that capital needs flow over to General Stabilization anyway, if Capital Stab. is inadequate, so they are already linked.
- The prescribed additions to Capital and General Stabil. from Free Cash, in para. D and J, appear to be additive, and potentially unachievable. In my opinion, if a prescribed action is so unlikely as to be waived every year, it should not be part of a policy or a stated goal.

- The Education-centered Stabilization funds are not addressed in these policies. My support of separate Stabilizations for G-M and the Tech School may seem to contradict an earlier comment, but I see a visibility value in these two funds that I don't see in a Capital vs. General separation.

Sec. V Capital Planning

- Para. A needs only to cite the bylaw, not reprint it. Para. B is unnecessary since the topic is covered in para. D and is part of the CIC's job in para. A. Similarly, it looks like para. E may be a verbatim repeat of another policy, complete with phantom subpara. 4 and 5 separations. If the policies already exist, perhaps citing them is adequate; the Finance policies can go directly from D to F without losing anything.
- I have heard from the CIC over the years that they evaluate and prioritize projects, but leave funding recommendations to the Finance Committee. Para. C expands their role; in addition, para. C and D of this Section imply that the CIC <u>responds</u> to the Town Administrator's submitted list rather than <u>initiating</u> planning and review tasks. The resulting combination of roles seems inconsistent with the bylaw in para. A
- In para. E. 4. E. and F the sanitary sewer and enterprise funds are mentioned; they are not part of the Operating unit defined in Sec. VII or the Revenue/Reserves in Sections III and IV.
- Borrowing is not an available funding source for Capital in para. F unless it is part of "special purpose funds" – which would be unnecessarily obscure. Yet a considerable part of Sec. VI is devoted to long-term debt as a funding source.
- Para. H and I establish an aggressive Capital Program, including yet another yardstick for Capital Stabilization – different from Sec. IV. J
- Para. J appears to establish a goal for Bldg Renewal spending separate from other capital requirements. This is another segregation and definition step that may not have a greater value than a more general and flexible practice.

Sec. VI Debt Management

- This entire Section seems more complex than necessary. Can it be re-arranged to separate sewer from town borrowing (if sewer is indeed included), statutory provisions vs. town goals, etc. Some of the conflicting or uncertain elements are listed here.
- The bonding criteria in para. D through H are different, and potentially looser, than in earlier Sections. Again, sewer issues are mentioned and a very tight affordability criterion (impact on rates) is applied to sewer borrowing in para. H but not to town borrowing elsewhere. Are enterprise funds IN or OUT?
- I recall the USDA terms and economic-life measures for sewer borrowing are longer than contemplated in para. E and I; durations on other bonding also seem tighter than our typical experience. I'm concerned that short bond-durations may starve other parts of town operations, in view of the spending/funding limitations on General Funds elsewhere in these policies.
- Para. F refers to continuation of a "current policy" to use excluded debt for projects over $500,000. I'm not aware of such a policy, and skeptical of its success at Town Meeting –

though I recall that "excluded debt" is not an enterprise-fund distinction, and our big projects tend to be sewer-related.

- Para. M envisions much higher debt service – and thus higher/faster borrowing – than we now have. Unexcluded debt service appears to be less than $120,000 in FY2015, only 0.7% of General Fund + Education.
- Para. E and N. 1 seem to set different thresholds for borrowing vs. cash funding. Para. N. 3 injects a sub-definition difference that is not in the Definitions.

Responses to Questions Raised by John Hanold
Relative to the Proposed Financial Policies and Procedures

(A.) Re: Covering E-Mail 19 May, 2014

(1) Reference to scheduled conference with Standard & Poors: This conference has not been officially scheduled yet, but our financial advisor felt that it should be July at the latest. We have notes coming due in July.

(2) References to "upcoming bond offerings" and to next 3 to 7 years: This statement relates to both borrowing already authorized including the sewer emergency ($1.7 Million) and last payment due on Public Safety Facility ($104,000). Based on my experience on the capital improvements committee, there are also several large potential projects that are in various planning stages (i.e. DPW garage, senior center, library, industrial park); and which are likely to require general obligation (GO) borrowing if approved by Town Meeting.

(3) Research: The scope of my research was confined to an internet search. A community attitudinal study would be much more extensive in scope and probably have to be done by a private consultant. If bond rating is any indication of success, the twenty cities and towns surveyed included five AAA and fourteen AA rated communities. In preparing my proposal I also did consult the Department of Revenue website on "Best Financial Practices."

(B.) Scope of Policies

(1) Scope of Draft: Yes, the primary focus of the draft is the General Fund. They are not considered as part of the "General Operating Budget" in the calculation of reserves. This does not mean that the self supporting or mostly self supporting entities (i.e. WPCF, Colle, Airport) cannot have reserve policies of their own. The Standard and Poors Public Finance Criteria Handbook clearly differentiates between tax funded and utilities (sewer/water) and transportation (airport) entities. When doing their evaluation of sewer enterprises, for example, they look at a whole range of criteria including: rates compared with neighboring communities and/or similar systems; rates in relation to the service area's wealth and income levels, and the rate setting process.

(2) Broaden Definition of Montague's Financial Health (to include enterprise funds). We could consider adding policies for the self supporting entities. For example: one AAA community, North Andover, has a policy related to sewer retained earnings: " to provide rate stability in the Water and Sewer Enterprise Funds, the funds will maintain retained earning equivalent to a minimum of three months of appropriated expenses. Retained earnings in excess of four months will be appropriated to offset user fees directly or indirectly through capital projects pay-as-you-go funding of enterprise fund projects."

(C) Section VII Definitions

(1) Scope: The list of definitions contained in Section VII is not meant to be exhaustive. We may want to include others or clarify the ones that are already included.

(2) Definition of Net Tax Levy: (??? Carolyn question)

(3) Assessor's Overlay: Some communities do treat the Assessor's Overlay as a "reserve" – but it is as an Assessor's Reserve "established per requirements of MGL Chapter 59, Section 25. North Andover, a AAA community has established a policy requiring the Selectmen to monitor the fund: "The Board of Selectmen shall, at the conclusion of each fiscal year, require the Board of Assessors to submit an update of the Overlay reserve for each fiscal year, including but not limited to, the current balances, amounts of potential abatements, and any transfers between accounts. If the balance of any fiscal year overlay exceeds the amount of potential abatements, the Board of Selectmen may request the Board of Assessors to declare those balances surplus, for use in the Town's Capital Improvement Plan (CIP) or for any other one-time expense."

(4) Yet to be Created Reserves: Yes. I agree.

(5) Appropriation Threshold for Stabilization Funds: Yes. All stabilization funds are subject to the same restrictions under Mass General Laws. As such, they would be subject to a 2/3 vote and the necessity of a town meeting appropriation into or out of the fund.

(6) GASB 34. I assumed that this is standard accounting language that would require no further clarification to the entities charged with compliance.

(7) Undesignated Fund Balance. Actually the amount of free cash certified as of July 1 of every year is only a portion (the amount that is available) of the total undesignated fund balance. Free Cash is now referred to in Massachusetts Accounting Statutes as the undesignated fund balance.

(D.) Capital Planning

(1) Unnecessary verbiage. No problem. It's omitted.

(2) CIC Process. I don't understand the issue. The Town Administrator is simply soliciting the requests from the departments, in a format in which the CIC can do their evaluation. The Town Administrator is not assuming any new authority. It is no different than the way Carolyn organizes the operating budget requests for your subsequent review. I am simply preparing the proposal package for the CIC. At this point the CIC meets with the departments, gathers more information about projects and establishes priorities for funding. Then, the CIC makes their recommendations to the Finance Committee and Town Meeting. We have always assumed that the Finance Committee recommends the ultimate source of funding.

(3) **Capital Projects for Self Funded Entities.** Yes, the WPCF and other enterprises are not part of the Operating Unit defined in Section VII; but each engages in the funding of capital projects. There is no reason why the same, general capital policies should not apply to both. Yes, I agree, if you are talking method of financing, then different reserve policies would apply (i.e. town stabilization vrs. Sewer retained earnings; town borrowing or sewer borrowing)

(4) **Borrowing:** You are correct. Borrowing is an obvious source of funding.

(5) **Capital Funding Commitment.** Yes. This is an aggressive goal, but not one that has not been attempted in other communities. The goal is to make a commitment to allocate some portion of the budget to capital. This usually includes a floor (between 2% and 3%) and a ceiling (around 10%). The rationale is that if you are not devoting a certain amount of your revenues to capital, you may be just deferring spending. The ceiling includes both debt service and pay-as-you-go (cash). Ideally, the capital stabilization ends up being a source of funding for the pay-as-you-go portion of this.

(6) **Building Renewal/Equipment Replacement:** I don’t agree. Actually, it would make sense if the 2% minimum commitment to capital spending is for building renewal/equipment replacement. This is the case in more than one community and seems to make a lot of sense. It has even been established in some communities as a special purpose stabilization fund for building renewal/equipment replacement.

(E.) Debt Management

(1) **Complex.** I am having trouble seeing where the confusion lies. What I am proposing is pretty much boiler plate language which addresses the key debt-related principles. I feel pretty confident in the debt policies that I have proposed. There is a lot of consensus among communities on what policies should be included. And debt policies are possibly as well defined because they receive special attention from the bond rating agencies. I am not proposing to reinvent the wheel.

(2) **Debt Hierarchy.** Sections D through H merely establish a suggested guideline for the use of debt. Items costing less than $25,000 (Item D), which is incidentally the minimum value of a capital project, should be financed through the operating budget; and not be financed through borrowing. Borrowing is only recommended for projects costing more than $25,000; and when the cost of a project reaches a certain level, the town should consider funding it though excluded debt, so as to minimize competition for operating budget funds. The staff agreed that $500,000 was a good limit to establish. I have seen it higher in other communities, but if it is too high, a large project will have a significant impact upon the operating budget if not excluded.

(3) **Duration of Bonds.** This is just good practice and one I think that we have practiced informally. Yes. The USDA bond was 40 years, but staff agreed that we should try to avoid that in the future. And 30 years only for the State Revolving Fund borrowings because that is what the program offers. As far as retiring 50% of the principal of outstanding bonds within 10 years, this seems to standard, good practice. One community even had a higher threshold of 65%. Maybe our financial advisor can weigh in on this one.

(4) **Minimum Threshold for Debt Exclusions.** Once again, staff seemed to think this was a good number. It could be higher or lower. The reality is that the town is facing about $10-$15 million in new debt over the next 5 to 7 years. If we don't establish a policy of excluding large projects from the cap we will have to trade off people and programs for new, badly needed facilities. Incidentally, the principle of committing to debt exclusions for large scale projects seems to be a consensus item among many communities.

(5) **Debt floor.** Item "M" assumes that the town will gradually commit to a higher level of capital spending that will be reflected in the minimum level of debt service of at least 2%. If we were adequately funding building replacement, we would easily exceed this number.

(6) **Thresholds for Borrowing vs. Cash.** It seems to do that, but what is actually being proposed is a goal to fund projects with cash that are eligible for borrowing (i.e. more than $25,000, but less than $50,000). It is meant to encourage more "pay-as-you-go" projects.